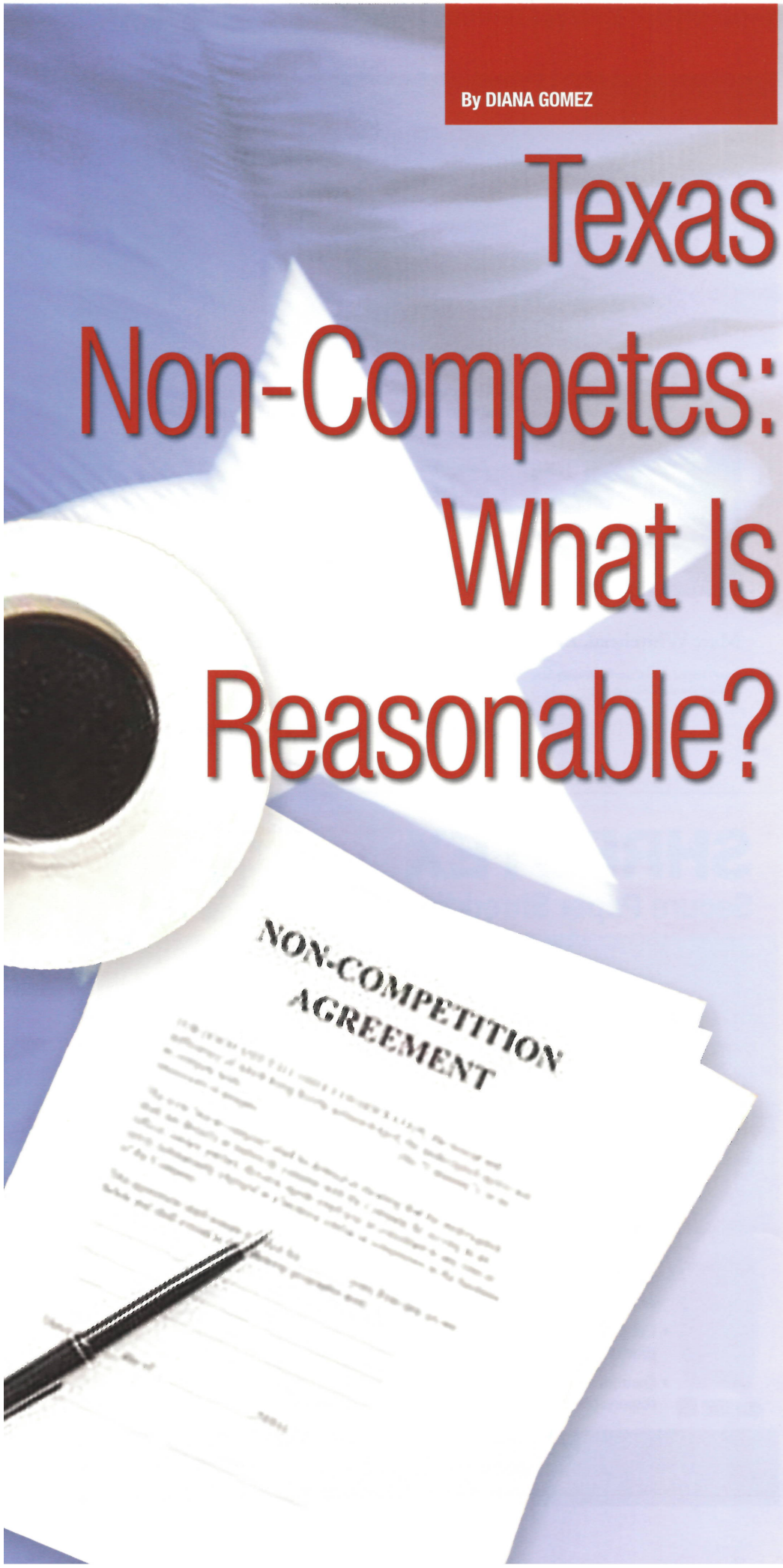
By DIANA GOMEZ

Texas Non-Competes: What Is Reasonable?



Non-compete litigation typically involves a business trying to stop a former employee from vying for its business customers. Non-compete litigation also includes other restrictive covenants that arise in the workplace from purchase agreements and broker-dealer relationships. Although these restrictive agreements have similar requirements for injunctions, case law provides slight variations on what constitutes a reasonable limitation depending on the relationship of the individuals entering the non-compete agreements. This article will discuss the general requirements and recent case law addressing non-competes between an employer-employee, involving a purchase agreement, and concerning a broker-dealer agreement.

I. Legal and Factual Requirements for Injunction

The enforceability of a covenant not to compete is a question of law.[1] "The hallmark of enforcement is whether or not the covenant is reasonable."[2] To be considered reasonable and consequently enforceable, the agreement must be (1) ancillary to or part of an otherwise enforceable agreement at the time the agreement is made[3] and (2) contain limitations as to time,[4] geographical area[5] (reasonable geographic scope is considered to be the territory in which the employee worked for the employer but a limitation to the clients the employee dealt with has also been found to be a reasonable alternative to a geographical limitation),[6] and scope of activity that do not impose a greater restriction than necessary.[7]

Texas courts have further held that the agreements cannot prohibit an employee from servicing clients acquired after the employee left,[8] and cannot prohibit an employee from servicing clients whom the employee had no contact with while associated with the former employer.[9] Non-compete agreement cases require a fact-specific analysis, and court decisions depend heavily on the circumstance of each particular case.

II. Employer & Employee Agreement, *Fomine v. Barrett*[10]

Fomine is a typical non-compete lawsuit. Alexei Fomine (Fomine) hired Rosa Barrett (Barrett) to work at Fomine's chiropractic clinic, Eastex Medical Clinic (Eastex). Barrett treated patients solely in Houston but also marketed to patients throughout Texas. Barrett signed separate agreements for confidentiality and non-compete, but both agreements were contained in a single document entitled "Confidentiality and Employee Non-Compete Agreement." The agreement "limited [Barrett] from owning, managing, operating, consulting, or being employed in a business substantially similar to or competitive with Eastex (i) for two years after any termination or expiration of her employment and (ii) within a 500 mile radius of the clinic's location."[11]

Barrett's employment was terminated and she opened a clinic 22 miles from Fomine's and another clinic seven miles from Fomine's clinic. Fomine sued for breach of the non-compete agreement. According to Fomine, Barrett entered into the agreement in exchange for confidential information, and Barrett obtained confidential and valuable information, e.g. patient files, referral sources, procedures for reducing bills, and training in a specialized industry.

In determining the reasonableness of the agreement, the court considered whether the 500-mile radius geographical limitation was necessary to protect Fomine's business interest. Before holding the geographical limitation to be unreasonable, the court noted "[t]he territory in which an employee worked for an employer is generally considered to be the benchmark of a reasonable geographic restriction."[12] Since the 500-mile radius included portions of five other states (and Mexico), which was significantly broader than the reach of Fomine's business, the court found this geographic restriction unreasonable.

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III. Purchase Agreement, *GTG Automation, Inc. v. Harris*[13]

GTG Automation Inc. (GTG) contracted to purchase Harris Plumbing Heating & Air from Kenneth Harris (Harris). Harris also executed an employment agreement to work for GTG following the purchase. The purchase contract included a covenant not to compete, which restricted Harris and his family from engaging in any business that would compete with GTG within a 250-mile radius for 5 years. Harris eventually resigned from GTG and began a new plumbing business. GTG sued Harris seeking, among other things, to enforce the non-compete agreement. The trial court reformed the non-compete agreement by reducing the 250-mile radius to a 50-mile radius and awarded GTG $35,000 for Harris's breach of the non-compete. GTG appealed.

In analyzing the non-compete language, the appellate court noted that covenants related to a sale of a business are afforded greater latitude than covenants made as part of an employment contract.[14] A reasonable area for an agreement in an employment contract is the territory worked by the employee, while a reasonable area for an agreement in a purchase is the area necessary to protect the goodwill purchased by the buyer.[15] The priority in analyzing a non-compete in a purchase agreement is "the nature and extent of the previously owned business."[16]

In addition to plumbing services, GTG also performed electrical and automation services for companies in a 250-mile radius. GTG argued unsuccessfully that it had goals of expanding its plumbing services out to the 250-mile radius. In reaching its decision to uphold the trial court's reformation of the non-compete to a 50-mile radius, the appellate court observed that GTG's electrical and automation services encompassed a 250-mile radius, but its plumbing services only encompassed a 50-mile radius. Furthermore, Harris only performed plumbing service for GTG within a 50-mile radius, and his company only serviced a 50-mile radius. Therefore, the 50-mile area was a reasonable area since it was the area of the previously owned business. Unclear from this decision is whether the geographical limitation would have been expanded to the 250-mile radius if GTG had performed plumbing services in a 250-mile radius.

Further, the appellate court held that since the non-compete was reformed, GTG was not entitled to the $35,000 in damages as a result of Harris's breach of the non-compete.[17] Pursuant to Section 15.51(c) of the Texas Business and Commerce Code, a court may not award "damages for a breach of the covenant before its reformation." Because of the trial court's reformation of the non-compete, GTG "was not entitled to the award of $35,000 for Harris's breach of the covenant prior to its reformation."[18]

IV. Broker-Carrier Agreement, *Central States Logistics, Inc. v. BOC Trucking, LLC*

Central States Logistics, Inc. d/b/a Diligent Delivery Systems (Diligent) is a broker arranging freight transport. BOC Trucking, LLC (BOC) is a company that transports freight. Diligent and BOC entered into a broker-dealer agreement with the following language,

For a period of twenty four (24) months following the Carrier's last contact with

any client or client[s] of Broker the Carrier agrees it shall not either directly or indirectly influence or attempt to influence customers or clients of Broker (or any of its present or future subsidiaries or affiliates) for whom the Carrier has rendered services pursuant to this Agreement to divert their business to the Carrier or any individual, partnership, firm, corporation or other entity then in competition or planning to be in competition in the future with the business of Broker or any subsidiary or affiliate of Broker.[19]

BOC began transporting freight for a company, Ameriforge, arranged by Diligent. Ten months later BOC formed a separate company and began transporting freight for Ameriforge. Diligent sued BOC for breaching the non-compete agreement, among other things. A jury found BOC liable for breach of contract and BOC appealed.

> *"In analyzing the non-compete language, the appellate court noted that two to five year time periods have been upheld as reasonable."*

In analyzing the non-compete language, the appellate court noted that two to five year time periods have been upheld as reasonable. However, the language at issue was for two years after BOC's last contact with any client of Diligent. This language "create[d] the potential for a covenant not to compete that does not end," since it remains in effect regardless of whether BOC had any previous interaction with Diligent's clients and regardless of whether the interaction was during or after the agreement. The appellate court held that a non-compete agreement extending for an "indeterminable amount of time" is simply not reasonable and therefore not enforceable.[20] Because BOC could not determine when the non-compete agreement ended, the agreement was not enforceable as written.

V. Fiduciary Duty, *Salas v. Total Air Services, LLC*[21]

At-will employees who do not sign non-compete agreements may still have fiduciary duties to their employers which prohibits how they may form a competing business.

Total Air Services, LLC (Total Air) sued its former employee, Heriberto Salas (Salas), after learning that Salas operated a competing business while still employed with Total Air. Salas did not sign a non-compete agreement but the court found that Salas owed his employer "at least some measure of a fiduciary duty."[22] Since Salas had authority to pull city permits, obtain final city inspection, assist in presenting quotes, and troubleshoot problems, he "was in a position to compete against Total Air on the very jobs that [Total Air] was bidding on."[23] In reaching its conclusion, the court focused on the fiduciary duty between an agent (employee) and a principle (employer) stating, "[a]n agent generally has a fiduciary duty to act for the benefit of his principal in all matters connected with the agency... [A]n agent who uses his position to gain a business opportunity belonging to the principal commits an actionable wrong."[24] While an at-will employee may plan to go into competition with his employer and take steps in that direction while employed, there are limitations. The court determined that an employee has a duty to act for the benefit of the employer in employment matters and may not steal trade secrets, solicit the employer's customers or employees while still working for the employer, or take the employer's confidential information.[25]

VI. Anti-SLAPP No Longer Applies to Non-Compete Actions

On September 1, 2019, the new amendments to Texas' anti-SLAPP (strategic lawsuits against public participation) statute, known as the Citizens Participation Act, took effect.[26] These new, non-retroactive[27] amendments now exclude non-compete matters between an employer and employee.[28]

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Endnotes

1. *Fomine v. Barrett*, No. 01-17-00401-CV, 2018 WL 6376500, 2018 Tex. App. LEXIS 10024, *7 (Tex. App.—Houston [1st Dist.] December 6, 2018).
2. *Id.* (citing *Marsh USA Inc. v. Cook*, 354 S.W.3d 764,768 (Tex. 2011)).
3. Tex. Bus. & Com. Code Ann. § 15.50(a).
4. *Id.*
5. *Id.*
6. *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 660 (Tex. App.—Dallas 1992, no writ); *Gallagher Healthcare Ins. Servs. v. Vogelsang*, 312 S.W.3d 640, 654 (Tex. App.—Houston [1st Dist.] 2009, pet. denied).
7. *Fomine*, 2018 Tex. App. LEXIS 10024, at *7; see Tex. Bus. & Com. Code Ann. §15.50(a).
8. In the case of covenants applied to a personal services occupation, such as that of a salesman, a restraint on client solicitation is overbroad and unreasonable when it extends to clients with whom the employee had no dealings during his or her employment. *Peat Marwick Main & Co. v. Haass*, 818 S.W. 2d 381, 388 (Tex. 1991); *John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80, 85 (Tex. App.—Houston [14th Dist.] 1996, writ denied) (quoting *Haass*, 818 S.W.2d at 386-88); *see Rimkus Consulting Grp., Inc. v. Cammarata*, 255 F.R.D. 417, 440 (S.D. Tex. 2008) (holding non-solicitation covenant that extended to customers with whom former employee never dealt unenforceable and "broader than necessary"); *see also SafeWorks, LLC v. Max Access, Inc.*, No. H-08-2860, 2009 WL 959969, at *4 (S.D. Tex. Apr. 8, 2009) (holding non-solicitation covenant that was not limited to clients with whom employee did business was overbroad and unenforceable).
9. *Id.*
10. *Fomine v. Barrett*, No. 01-17-00401-CV, 2018 WL 6376500, 2018 Tex. App. LEXIS 10024 (Tex. App.—Houston [1st Dist.] December 6, 2018)
11. *Fomine*, 2018 Tex. App. LEXIS 10024, 2018 WL 6376500 at *1.
12. *Id.* at *8.
13. *GTG Automation, Inc. v. Harris*, No. 11-16-00317-CV, 2018 WL 5624206, 2018 Tex. App. LEXIS 8876 (Tex. App. – Eastland October 31, 2018, no pet.)
14. *GTG Automation, Inc. v. Harris*, No. 11-16-00317-CV, 2018 WL 5624206, 2018 Tex. App. LEXIS 8876, *3 (Tex. Civ. App.—Eastland, Oct. 31, 2018, no pet.)
15. *Id.*
16. *Id.*
17. *Id.* at *4.
18. *Id.*
19. *Cent. States Logistics, Inc. v. BOC Trucking, LLC*, 573 S.W.3d 269, 277 (Tex. App.—Houston [1st Dist.] 2018, pet. filed).
20. *Id.* at 276-77.
21. *Salas v. Total Air Services, LLC*, 550 S.W.3d 683 (Tex. App. – El Paso, 2018 no pet.)
22. *Salas*, 550 S.W.3d at 691.
23. *Salas*, 550 S.W.3d at 691-692.
24. *Id.* at 690.
25. *Id.* at 691.
26. Act of June 2, 2019, 86th Leg., R.S., ch. 378, 2019 Tex. Gen. Laws 378 (codified at Tex. Civ. Prac. 550 S& Rem. Code Ann. § 27.001-27.011).
27. Act of June 2, 2019, 86th Leg., R.S., ch. 378, 2019 Tex. Gen. Laws 378, §11.
28. TEX. CIV. PRAC. & REM. CODE ANN. § 27.010(a)(5).